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In the Supreme Court of the United States

OCTOBER TERM, 1946

THE UNITED STATES, PETITIONER

v.

THE MUNSEY TRUST COMPANY OF WASHINGTON,
D. C., RECEIVER

PETITION FOR A WRIT OF CERTIORARI TO THE COURT
OF CLAIMS

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The Acting Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims of the United States entered in the above-entitled case on October 7, 1946.

OPINION BELOW

The opinion of the Court of Claims (R. 17-28) is reported at 67 F. Supp. 976.

JURISDICTION

The judgment of the Court of Claims was entered on October 7, 1946 (R. 28). The juris-

diction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended.

QUESTION PRESENTED

Whether the United States may set off an indebtedness due from a contractor on an independent transaction against a balance due to the contractor on certain construction contracts where a surety under payment bonds has satisfied unpaid material and labor claims under those contracts.

STATUTES INVOLVED

[The pertinent portions of the statutes involved are set forth in Appendix A, *infra*, pp. 14-20.

STATEMENT

The facts as found by the Court of Claims may be briefly summarized as follows:

The Federal Contracting Corporation, a New York corporation (contractor), between May 10 and July 26, 1940, entered into six contracts with the United States, through the Public Buildings Administration, for the painting and repair of various buildings belonging to petitioner (R. 17-18). The Aetna Casualty and Surety Company (surety) furnished the two bonds required of the contractor under each of the contracts, one guaranteeing the performance of the contract and the other guaranteeing payment of materialmen and

laborers (R. 18).¹ In connection with these bonds the contractor entered into "Agreements of Indemnity" with the surety whereby it agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned to the surety all moneys that might be due and payable to it on its failure to pay bills incurred in the work (R. 14). The contractor failed to make payments, totaling \$13,065.93, to persons who had furnished labor and material for use in the performance of five of the contracts. The surety made these payments in accordance with its obligation under the payment bonds (R. 18). Upon completion of the contracts by the contractor and after allowance of credit for payments made, there remained due and owing from the United States to the contractor a total of \$12,445.03 on account of the six contracts (R. 18).

On October 18, 1940, the contractor submitted a bid to the United States for the painting of the United States Post Office at St. Louis, Missouri. The bid was accepted but the contractor failed to enter into the contract therefor and failed to give the bond required in connection therewith. Thereupon, the work was relet and performed at a cost of \$7,146.50 over and above the contractor's bid. After the application of the bid deposit of

¹ These bonds are required by the Miller Act, 49 Stat. 793, 40 U. S. C. 270a *et seq.*, Appendix A, *infra*, pp. (14-17). The Miller Act replaced the Heard Act, 33 Stat. 811, 40 U. S. C., 270, Appendix A, *infra*, pp. 18-20.

\$415 there remained an indebtedness due to the United States from the contractor of \$6,731.50 (R. 19-20).

On June 4, 1941, one Klein, a stockholder of the contractor, instituted an action entitled "*Klein v. Henry Morgenthau, Jr., Secretary of the Treasury of the United States et al.*," Civil Action No. 11643, in the District Court of the United States for the District of Columbia, seeking the appointment of a special receiver² for the amounts due under the above-mentioned six contracts, and the distribution of those amounts to the laborers and materialmen or, in the alternative, to the surety, who, by counter claim and cross claims, joined in the same prayers. Subsequently the Munsey Trust Company, a District of Columbia banking corporation was appointed receiver and directed by the order of its appointment to collect from the United States all moneys due under the six contracts, and to hold the proceeds of such collection for the reimbursement of the surety for expenditures made by it in its payment to furnishers of labor and material under the six contracts. The action was dismissed as against the Secretary of the Treasury, the Treasurer of the United States and the Commissioner of the Public Buildings, who had been named as defendants.

² In accordance with the established procedure in the courts of the District of Columbia, such receivership is for the purpose of taking possession of a fund or property and preventing its loss or dissipation. It does not necessarily involve insolvency, and in the action in the district court, no claim of insolvency was made by either party.

Pursuant to the order of its appointment, respondent made demand upon the United States for the proceeds of the balances due under the several contracts. The General Accounting Office paid to respondent the balances due under the six contracts except for the amount of \$6,731.50 which was applied in liquidation of the contractor's indebtedness to the United States by reason of its default under the St. Louis Post Office contract. Respondent and the surety each protested this set-off, but the Comptroller General affirmed the action taken in the matter. Respondent reported these facts to the United States District Court in the action in which it was appointed receiver and was authorized and directed to institute suit in the Court of Claims for the recovery of such further amounts as may be due under the six contracts.

In the Court of Claims, respondent, who had received \$5,713.53, claimed that it was entitled to a further balance of \$3,568.23 for the benefit of the surety, on the ground that the surety was entitled to a total of \$9,281.76 representing the payments to laborers and materialmen made by it under each contract to the extent that each contract balance was sufficient to permit such payment.³

³ Finding No. 10 of the court below (R. 17) shows the balances due under each contract, payments by the surety to the furnishers of labor and material under each contract, and the amounts claimed by respondent under each contract.

The court below held that when the surety paid the claims of the laborers and materialmen, it was subrogated to all the equities in their favor, which although "not a lien in the strict and proper sense, brings kindred consequences along with it" (R. 25); that "neither the general right of the Government to make offsets nor the provisions of sec. 236 R. S. give to the claim of the Government any greater equitable force and effect than would attach to the claim of any general creditor to the contract balances in the Government's hands" (R. 27); and therefore that "the right of the surety and of plaintiff, as receiver, which is in the nature of an equitable lien, to have the contract balances in the Government's hands applied in satisfaction of payments made by the surety to laborers and materialmen cannot be displaced by the Government's general right of offset" (R. 28).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that the rights of the surety upon paying the claims of the materialmen and laborers, although "not a lien in the strict and proper sense, brings kindred consequences along with it."
2. In holding that upon paying the claims of contractor's materialmen and laborers, the rights of the surety to the fund in the hands of the Government were superior to the right of the Government to a setoff.

3. In holding that the United States, in respect of the retained fund, was merely a stakeholder.

4. In holding that despite the general right of the Government to make offsets, its claim to the retained fund was no better than that of a general creditor of the contractor.

5. In holding that despite the provisions of Rev. Stat. 236, the Government's claim to the retained fund was no better than that of a general creditor of the contractor.

6. In holding that the United States could not set off its claim against the contractor against the balance due to him because of the equities of the surety.

7. In entering judgment for the respondent.

REASONS FOR GRANTING THE WRIT

1. The holding of the Court of Claims that a surety who has paid claims of materialmen and laborers against his principal has priority to the contract balance in the hands of the Government as against the Government's right to set off the contractor's liability to it against such balance in effect vests in the surety rights superior to those to whom he was subrogated, and ignores the basic principle that "The party for whose benefit the doctrine of subrogation is exercised can acquire no greater rights than those of the party for whom he is substituted." *Globe Indemnity Co. v. United States*, 84 C. Cls. 587,

595, certiorari denied, 302 U. S. 707; *Southern Surety Co. v. United States*, 75 C. Cls. 47; *Alexander v. Young*, 65 F. (2d) 752, 757 (C. C. A. 10); *Swartz v. Siegel*, 117 Fed. 13, 15, 16 (C. C. A. 8); *Sheldon Subrogation* (2d Ed.), §§ 1, 6.

In the present case, the surety, upon paying the claims of the contractor's laborers and materialmen, apparently became subrogated to the rights of both the contractor and the laborers and materialmen. If the contractor himself had discharged these liabilities, he clearly would be unable to oppose the Government's setoff since, in these circumstances, the Government unquestionably has the right, and the General Accounting Office the duty, to make such setoff both under the general law and under Rev. Stat. 236, 31 U. S. C. 71, Appendix A, *infra*, p. 14. *Barry v. United States*, 229 U. S. 47, 53; *Gratiot v. United States*, 15 Pet. 336; *McKnight v. United States*, 13 C. Cls. 292, affirmed 98 U. S. 179; *Taggart v. United States*, 17 C. Cls. 322, 327; *American Sanitary Rug Co. v. United States*, 84 C. Cls. 417; *John P. Squire Co. v. United States*, 90 C. Cls. 276. Nor does subrogation to the rights of the materialmen and laborers place the surety in such a preferred position. Even in the absence of a bond securing payment of their claims, unpaid materialmen and laborers on a public contract would have no legally binding claim against the United States. *Kellogg v. United*

States, 7 Wall. 361; *H. Herfurth, Jr., Inc. v. United States*, 89 C. Cls. 122. At most, the United States had the moral obligation to see that the materialmen and laborers were paid. Cf. *Henningsen v. U. S. Fidelity & Guaranty Co.*, 208 U. S. 404; *California Bank v. U. S. Fidelity & Guaranty Co.*, 129 F. (2d) 751, 754 (C. C. A. 9).

Contrary to the finding of the court below, the effect of the Miller Act, Appendix A, *infra*, pp. 14-17, and its predecessor Heard Act, Appendix A, *infra*, pp. 18-20, and the bonds required thereunder, could not be to give the surety a right or interest which "if not a lien in the strict and proper sense brings kindred results along with it" (R. 25). Such finding is tantamount to holding that the surety did obtain an equitable lien, a conclusion which the court below has admitted is improper. See *Seaboard Surety Co. v. United States*, 67 F. Supp. 969, 972 (C. Cls.), and cases there cited. As a matter of fact, the purpose of these Acts was to provide protection for such materialmen and laborers by creating a new cause of action for these creditors against the surety. *MacEvoy Co. v. United States*, 322 U. S. 102; *Texas Cement Co. v. McCord*, 233 U. S. 157; *Hill v. American Surety Co.*, 200 U. S. 197; *United States Fidelity and Guaranty Co. v. United States*, 191 U. S. 416. It would be anomalous if the surety should have rights which are denied to the class for whose protection the bond is required.

The court below improperly treated the United States as the holder of the fund separable from its creditor relationship to the contractor, and based its finding that the surety had priority to the retained fund on cases such as *Prairie State Bank v. United States*, 164 U. S. 227.⁴ In that case, the question was whether a bank to which the contractor had assigned sums due under a building contract or the surety on the performance bond who had taken over and completed the work after the contractor's default was entitled to the money which the Government retained as a special fund to assure performance. The Government was solely a stakeholder, and made no claim to the fund. In the present case, the United States is not claiming priority over the surety

⁴The court below quoted at length from *Henningsen v. United States Fidelity & Guaranty Co.*, 208 U. S. 404; *Moran v. Guardian Casualty Co.*, 76 F. (2d) 438 (App. D. C.); *Farmers' Bank v. Hayes*, 58 F. (2d) 34 (C. C. A. 6); *United States Fidelity and Guaranty Co. v. Sweeney*, 80 F. (2d) 235 (C. C. A. 8); *Morgenthau v. Fidelity & Deposit Co.*, 94 F. (2d) 632 (App. D. C.). All these cases involved substantially the same situation as the *Prairie Bank* case, and were decided ultimately on the authority of that case. The court below also cited *United States Fidelity and Guaranty Co. v. United States*, 92 C. Cls. 144 (R. 18). In that case the surety on a performance bond elected to complete a contract after the contractor's default and entered into a supplemental agreement with the United States providing that any amounts retained from payments made to the original contractor should be paid to the surety upon completion of the work. In accordance with the terms of the supplemental contract, the Court of Claims held that the surety was entitled to the retained amounts.

to a fund in the hands of a third person, but asserts that under the general law and statutes, it has the right to set off the debt of the contractor to it against its debt to the contractor. Moreover, there is not here present, as in the *Prairie Bank* case, a right on the part of the surety to be subrogated to the rights of the United States against the retained funds. First, the obligation discharged—the payment of claims of laborers and materialmen—was not that of the United States. And, in the second place, all claims of the United States had not been satisfied. Cf. *United States v. National Surety Co.*, 254 U. S. 73. Since the cases relied on by the court below do not involve any claim of the United States to setoff, these cases, we submit, are inapplicable.

Maryland Casualty Co. v. United States, 100 C. Cls. 513, is the only case where the precise question here involved has been decided.⁵ The basis of the court's decision in that case was a promise by the Government to the surety, implied from

⁵ *Dewey Schmoll v. United States*, 105 C. Cls. 415, certiorari denied October 14, 1946, and *Seaboard Surety Co. v. United States*, 67 F. Supp. 969 (C. Cls.), involved the additional fact of an assignment for the benefit of creditors. In those cases, the Court of Claims properly held that in those circumstances Rev. Stat. 3466, Appendix B, *infra*, p. 21, accorded the Government priority over the surety. The United States opposed the granting of a writ of certiorari in the *Dewey Schmoll* case on the ground that because of Rev. Stat. 3466 the question there presented was very narrow and correctly decided by the Court of Claims, but that statute is not involved in the present case.

the bond and transaction as a whole, that it would not so settle the accounts as to leave the surety in the position of paying the contractor's debts (100 C. Cls. at 520-521). Here again the decision of the court below was erroneous, since the Government's right of setoff has long been established by judicial decisions and statute, and is an old and well-recognized practice in the General Accounting Office. See cases cited, *supra*, p. 8. No good reason appeared why the surety should not have been charged with knowledge of that right and practice. *Dewey Schmoll v. United States*, 105 C. Cls. 415, certiorari denied October 14, 1946; *Von Hoffman v. City of Quincy*, 4 Wall. 535, 550; cf. *Hill v. American Surety Co.*, 200 U. S. 197, 203, 205.

2. The question presented in this case is one of substantial importance meriting review by this Court. Prior to the *Maryland Casualty* case, the General Accounting Office, the agency charged with the administration of Rev. Stat. 236, had consistently set off mutual claims in such situations, which arise frequently. If not reversed, the instant case, together with *Maryland Casualty* case, will create serious administrative problems for the General Accounting Office. Where the contractor is actually insolvent, that agency will be forced to initiate innumerable receivership proceedings for the purpose of invoking Rev. Stat. 3466, and thereby to secure recognition of, and protect, the Government's right of setoff. *Dewey*

Schmoll v. United States, supra; Seaboard Surety Co. v. United States, supra. On the other hand, if, as appears to be the situation in the present case, the contractor is not insolvent, and has enough assets to pay both the Government and the surety (see footnote 2, p. 4), the effect of the instant decision will be "circuity of action, inconvenience; expense, consumption of the courts' time, and injustice" (cf. *Cherry Cotton Mills, Inc. v. United States*, 327 U. S. 536, 539)—results which the setting off of mutual debts prevents.

CONCLUSION

For the reasons stated, it is respectfully submitted that this petition for a writ of certiorari should be granted.

✓ GEORGE T. WASHINGTON,
Acting Solicitor General.

JANUARY 1947.

APPENDIX A

1. Rev. Stat. 236; 31 U. S. C. 71 provides:

All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office.

2. The Miller Act, 49 Stat. 793, 40 U. S. C. 270a *et seq.* provides:

Sec. 1. That (a) before any contract exceeding \$2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than \$1,000,000 the said payment bond shall be in a sum of one-half

the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than \$1,000,000 and not more than \$5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than \$5,000,000 the said payment bond shall be in the sum of \$2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases specified in subsection (a) of this section.

Sec. 2. (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under this Act and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him:

Provided, however, That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered mail, postage prepaid, in an envelop addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner, in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit.

SEC. 3. The Comptroller General is authorized and directed to furnish, to any

person making application therefor who submits an affidavit that he supplied labor or materials for such work and payment therefor has not been made or that he is being sued on any such bond, a certified copy of such bond and the contract for which it was given, which copy shall be prima facie evidence of the contents, execution, and delivery of the original, and, in case final settlement of such contract has been made, a certified statement of the date of such settlement, which shall be conclusive as to such date upon the parties. Applicants shall pay for such certified copies and certified statements such fees as the Comptroller General ~~fixes~~ to cover the cost of preparation thereof.

SEC. 4. The term "person" and the masculine pronoun as used throughout this Act shall include all persons whether individuals, associations, copartnerships, or corporations.

SEC. 5. This act shall take effect upon the expiration of sixty days after the date of its enactment, but shall not apply to any contract awarded pursuant to any invitation for bids issued on or before the date it takes effect, or to any persons or bonds in respect of any such contract. The Act entitled "An Act for the protection of persons furnishing materials and labor for the construction of public works", approved August 13, 1894, as amended (U. S. C., title 40, sec. 270), is repealed, except that such Act shall remain in force with respect to contracts for which invitations for bids have been issued on or before the date this Act takes effect, and to persons or bonds in respect of such contracts.

3. The Heard Act, 33 Stat. 811, 40 U. S. C. 270 which was superseded by the Miller Act, provides:

* * * any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners. If no suit should be brought by the United States within six months from the completion and final settlement of said contract, then the person or persons supplying the contractor with labor and mate-

rials shall, upon application therefor, and furnishing affidavit to the Department under the direction of which said work has been prosecuted that labor or materials for the prosecution of such work has been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond, upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the United States in the district court of the United States in the district in which said contract was to be performed and executed, irrespective of the amount in controversy in such suit, and not elsewhere, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and execution: *Provided*, That where suit is instituted by any of such creditors on the bond of the contractor it shall not be commenced until after the complete performance of said contract and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract, and not later: *And provided further*, That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into court, for distribution among said claimants and creditors, the full amount of

the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the United States by reason of the execution of said bond, and upon so doing the surety will be relieved from further liability: *Provided further*, That in all suits instituted under the provisions of this Act such personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors, and in addition thereto notice of publication in some newspaper of general circulation, published in the State or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor.

APPENDIX B

- Rev. Stat. 3466, 31 U. S. C. 191 provides:

Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

(21)